Supreme Court, U.S.
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No. 92-641

In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK, F.A.,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF ON THE MERITS OF RESPONDENT AMERICAN SAVINGS BANK, F.A.

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QUESTION PRESENTED FOR REVIEW

Does 11 U.S.C. § 1322(b)(2) (1988) prohibit a debtor from bifurcating a secured claim, secured only by a security interest in real property that is the debtor's principal residence, into a secured portion equal to the value of the real property and an unsecured portion for the remainder of the indebtedness?

LIST OF ALL PARTIES TO THE PROCEEDING IN THE COURT WHOSE JUDGEMENT IS SOUGHT TO BE REVIEWED

Leonard Nobelman – Debtor and Petitioner

Harriet Nobelman – Debtor and Petitioner

American Savings Bank, F.A. – Creditor and Respondent

Murray Mortgage Company n/k/a STM Mortgage Company – Servicing Agent for Creditor and Respondent

Molly W. Bartholow (formerly Tim N. Truman) – Standing Chapter 13 Trustee

Charles L. Kennan, III – Attorney for Chapter 13 Trustee

Terre M. Vandaman – Attorney for Harold J. Barkley, Jr., Amicus Curiae

William E. Cumberland and Michael L. Riddle – Attorney for Mortgage Bankers Association of America, Amicus Curiae

Dean S. Cooper and Carla E. Craig – Attorney for Federal Loan Mortgage Corporation, Amicus Curiae

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In re Nobelman, 129 B.R. 98 (N.D. 1991) (Pet. Cert., App. 16-31)

In re Nobelman, Case No. 390-35116-HCA-13 (Bankr. N.D. Tex. 1991) (Pet. Cert., App. 32-35)

STATEMENT OF JURISDICTION

Petition for Certiorari was filed on October 13, 1992, from the Judgement of the Court of Appeals, which was entered on August 13, 1992, giving jurisdiction under 28 U.S.C. Section 1254.

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS WHICH THE CASE INVOLVES

I. Amendment V to the Constitution of the United States of America:

> No person shall be held to answer for a capital, or otherwise infamous crime, unless a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor

shall private property be taken for public use, without just compensation.

II. 11 U.S.C. § 101(5) (1988):

(5) "claim" means –

(A) right to payment, whether or not such right is reduced to judgement, liquidated, fixed, continent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, dispute, undisputed, secured, or unsecured;

III. 11 U.S.C. § 506(a) (1988):

(a) An allowed claim of a creditor secured by a lien property in which the estate has interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

IV. 11 U.S.C. § 1322(b)(2), (5) (1988):

(b) Subject to subsections (a) and (c) of this section, the plan may –

(1) modify the rights of holders of secured claims, other than a claim secured only by security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(2) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

V. 11 U.S.C. § 1325(a)(5) (1988):

(a) Except as provided in subsection (b), the court shall confirm a plan if –

(5) with respect to each allowed secured claim provided for by the plan –

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder.

STATEMENT OF THE CASE

On June 21, 1984, Leonard and Harriet Nobelman (the "Debtors") executed a Note in the amount of $68,250.00 payable to American Savings Bank, N.A. ("American"), secured by a purchase money Deed of Trust on the primary residence of the Debtors. Murray Mortgage Company n/k/a STM Mortgage Company is the duly authorized servicing agent of American. (Petition for Cert., App. 32-33).

On August 6, 1990, the Debtors filed a voluntary petition for relief under Chapter 13 of United States Bankruptcy Code. On August 14, 1990, American filed its proof of claim for $71,265.04 which was later amended as a claim for $71,335.04. The Debtors filed their Chapter 13 Plan of Reorganization (the "Plan") on August 31, 1990, which was later modified. The Plan valued their residence at $23,500.00. The Debtors filed a Motion for Valuation along with the modifications to their Plan. At confirmation hearing, the Debtors offered the testimony of Leonard Nobelman, regarding the value of the property. No controverting evidence of the value was offered by any other party. (Petition for Cert., App. 32-33)

The Plan proposes to make direct payments to American at the mortgage contract rate only up to scheduled value of the collateral. The balance of American's claim ($41,257.66) is treated as a general unsecured claim under the Plan, payable *pari passu*. The unsecured creditors

receive nothing under the Chapter 13 Plan. Additionally, the Debtors propose to cure the prepetition arrearage owed to American through their Plan. Both American and the Standing Chapter 13 Trustee objected to confirmation. On the grounds that, *inter alia*, the Plan purports to alter the lienholder's rights as prohibited by 11 U.S.C. § 1322(b)(2) (1989 Supp.). (Petition for Cert., App. 32-33)

Accordingly, the Bankruptcy Court denied confirmation of the Nobelmans' modified Chapter 13 Plan as an impermissible modification of American's claim pursuant to the provisions of 11 U.S.C. § 1322(b)(2). On appeal, both the District Court and the Court of Appeals affirmed. (Petition for Cert., App. 1, 16, 32)

SUMMARY OF ARGUMENT

The Nobelmans in their Chapter 13 reorganization proceeding seek to bifurcate (*e.g.* "cram down" or "lien-split") the amount owing on their purchase money home mortgage loan into secured and unsecured portions, to repay the secured portion through their proposed plan of reorganization, and to discharge the unsecured portion under 11 U.S.C. § 1328 (1988). To achieve this result, they invoke 11 U.S.C. § 506(a) (1988), which provides that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of . . . such creditor's interest in the estate's interest in such property" and is an unsecured claim as to the remainder.

The Bankruptcy Court, the District Court and the Fifth Circuit Court of Appeals rejected this argument,

concluding that application of § 506(a) in the context of Chapter 13 reorganizations would impermissible modify the claim of American secured by the Nobelmans' principal residence, in violation of 11 U.S.C. § 1322(b)(2) (1988). That section specifically provides that the *rights* of a holder of "a claim secured only by a security interest in real property that is the debtor's principal residence" may *not* be modified as a part of Chapter 13 reorganization.

The lower court's decision should be affirmed because a natural reading of the plain statutory language of Section 1322(b)(2) demonstrates that a claim held by a home mortgage lender may *not* be bifurcated. Moreover, the structure of the Bankruptcy Code is such that § 506(a) is *not* self-executing and does *not* automatically turn the claim of a residential mortgage lender into secured and unsecured portions. Further, bifurcating a residential mortgage debt is inconsistent with the overall scheme of the Bankruptcy Code because it provides a windfall to Chapter 13 debtors without furthering its "fresh start" objective. In short, the Nobelmans' interpretation of § 1322(b) drains the statute of meaning and contravenes public policy which abhors the results of bifurcation upon the home mortgage industry and the home buying public.

The reasoning supporting the lower court's order is also founded upon a proper review of the legislative history of 11 U.S.C. § 1322(b) (1988) as set forth in *Grubbs v. Houston First American Savings Association*, 730 F.2d 236 (5th Cir. 1984). That Court, facing the question of whether a Chapter 13 Plan could cure a default on a residential loan, reviewed the legislative process and history and

concluded that Congress intended to permit a cure of defaults under 11 U.S.C. § 1322(b) (1988), but *not* modifications of the underlying residential loan indebtedness. Congress' history is clear that bifurcation is *not* to be allowed as against residential mortgage lenders. Accordingly, the opinion of the Fifth Circuit should be affirmed.

ARGUMENT

I.

THE PLAIN LANGUAGE OF § 1322(b)(2) PROHIBITS A DEBTOR FROM BIFURCATING A CLAIM, SECURED ONLY BY A SECURITY INTEREST IN REAL PROPERTY THAT IS THE DEBTOR'S PRINCIPAL RESIDENCE, INTO A SECURED PORTION EQUAL TO THE VALUE OF THE REAL PROPERTY AND AN UNSECURED PORTION FOR THE REMAINDER OF THE INDEBTEDNESS.

A complete and proper determination of the question presented for review in this case begins and ends with the plain language of § 1322(b)(2). *See Patterson v. Shumate*, 504 U.S.___, 112 S. Ct. 2242, 2245 (1992); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, ___, 109 S. Ct. 1026, 1030 (1989). "In determining the meaning of any statute, the words of the statute are 'the primary, and ordinarily the most reliable, source of interpreting its meaning.' " *In re Chavez*, 117 B.R. 733, 735 (Bankr. S.D. Fla. 1990) (quoting *Watt v. Alaska*, 451 U.S. 259, 266, n. 9, 101 S. Ct. 1673, 1678, n. 9 (1981)). "[W]here the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.' " *Ron Pair*, 109 S. Ct. at

1030 (quoting *Caminetti v. United States* 242 U.S. 470, 485, 37 S. Ct. 192, 194 (1917)).

This Court has recently looked to the plain language and natural reading of statutory provisions, *Patterson v. Shumate*, 112 S. Ct. at 2242; that "a legislature . . . means in a statute what it says . . . " *Connecticut National Bank v. Germain*, 503 U.S. ___, 112 S. Ct. 1146, 1149 (1992); and that courts must give effect to the plain meaning of a statute. *Union Bank v. Wolas*, 502 U.S. ___, 112 S. Ct. 527, 531 (1992). In fact, in the *Ron Pair* decision, this Court analyzed the effect of § 506(b) with regard to the question of an over secured creditor's right to postpetition interest by looking first to the natural reading of the statute and then to the statute's grammatical structure. 109 S. Ct. at 1030. An application of the *Ron Pair* methodology to § 1322(b)(2) mandates the result afforded by the *Nobelman* courts below for the following reasons.

(a) "Rights" of Holders Defined

Section 1322(b)(2) contains three distinct phrases. It begins by giving a plan proponent an option – "the plan may. . . . " One of the options is the language at issue in this case – "modify the rights of holders of secured claims. . . . " Alternatively, a plan proponent may choose to "leave unaffected the rights of holders of any class of claims. . . . " Finally, the statute sets forth an exception to the choices of a debtor – "other than a claim secured only by a security interest in real property that is the debtor's principal residence. . . . " The structure of the statute is such that the "other than" exception phrase follows the first option – the right to modify.

Courts which approve of lien bifurcation under § 1322(b)(2) almost uniformly assume that the word "modify" refers to a creditor's "secured claim" (as that term is defined by § 506(a)). *See, e.g., In re Houghland*, 866 F.2d 1182, 1183 (9th Cir. 1989); *contra Bellamy v. Federal Home Loan Mortgage Corporation*, 962 F.2d 176, 179 (2d Cir. 1992). The Ninth Circuit, for example, points to 11 U.S.C. § 103(a) (1988) as making the general definitional provisions of § 506(a) applicable to Chapter 13 proceedings and automatically splits a creditor's claim into secured and unsecured portions. *Houghland*, 866 F.2d at 1183. Such rationalization ignores the plain language of the statute and the method of statutory interpretation taught by *Ron Pair*.

The plain language of the statute indicates that the grammatical object of the verb "modify" in the phrase preceding the first comma is the word "rights." *Nobelman v. American Savings Bank*, 968 F.2d 483, 485 (5th Cir. 1992); *In re: Etchin*, 128 B.R. 662, 666 (Bankr. W.D. Wis. 1991). Further, the term "secured claim" in this phrase is the object of the preposition "of." This prepositional phrase is an adjective which describes the type of "holders" being discussed in the statute. Thus, a clear and natural reading of the "modify" phrase of § 1322(b)(2) indicates that it is the *rights* of secured claim holders which *may* be modified. "Secured claims" in contrast is purely descriptive and in context, does not implicate an issue of valuation which calls for § 506(a) application.

The permissive "may" in the statute indicates what a plan can or cannot include. To interpret § 1322(b)(2) as itself effecting bifurcation is inconsistent with its structural purpose. Clearly, rights are to be modified in plans – not in the abstract. To hold that rights come into plans

already modified stands in the purpose of § 1322(b)(2) on its head.

At least one pro-bifurcation court has, however, correctly recognized the objective of the word "modify" as being the object of word "rights". *Bellamy*, 962 F.2d at 179. What the Second Circuit in *Bellamy* fails to recognize, in its decision, is what the word "rights" actually means in the context of § 1322(b)(2).

The Bankruptcy Code provides no definition of the word "rights." Many of these rights, however, have been judicially recognized. *See Dewsnup v. Timm*, 502 U.S.___, 112 S. Ct. 773, 777-79 (1992). A creditor who holds a debt secured by real property has the right to expect payment of the debt according to the terms of the debt instrument *Id.* Alternatively, upon default, the creditor has the right to proceed to foreclosure of the lien securing the debt. *Id.* These are basic rights.

Beyond these rights, however, such a creditor may have rights to demand preservation and non-waste of its collateral, to benefit from a borrower's credit life and disability insurance, to demand borrower occupancy of residential property in certain circumstances, to benefit from private mortgage, FHA or VA loan insurance, as well as other important rights. To define what "rights" are, requires a reference to non-bankruptcy law. *Cf. Barnhill v. Johnson*, 503 U.S. ___, 112 S. Ct. 1386, 1389 (1992) ("In the absence of any controlling federal law, 'property' and 'interest in property' are creatures of state law.").

The Second Circuit would have us view the definition of the term "rights" solely through the lens of § 506(a). *Bellamy*, 962 F.2d at 179. In that case, the court of

appeals ruled that bifurcation is permissible as against a residential real estate lender by posing the "real question" of "whether the 'rights' to which § 1322(b)(2) refers include the mortgagee's rights concerning its claim or its rights with respect to its secured claim." *Id.* The Second Circuit assumes incorrectly that the term "secured claim" fully defines the "rights" of such a holder. The *Bellamy* court rationalizes its decision by reference to the "cornerstone" of the Bankruptcy Code, namely that it effected a fundamental change from the Bankruptcy Act. *Id.* Such reasoning, however, completely ignores the plain language of the statute.

If Congress intended protection only for the secured portion of a creditor's home mortgage claim, then it would have written § 1322(b)(2) to read that a Chapter 13 plan may ". . . modify the rights of holders of *secured* claims . . . " This plainly is not the case. The term "rights," however, is not defined by the Bankruptcy Code to extend only to a residential lender's claim. The word "rights" must refer to the non-bankruptcy rights of a secured creditor. The valuation component of § 506(a) cannot, therefore, be automatically implemented in connection with § 1322(b)(2) merely because the latter statute includes the phrase "secured claim."

Given that the word "rights" includes a broader scope of elements than those listed by the Second Circuit, the next inquiry must be how are these rights affected by the anti-modification provision of § 1322 (b)(2). Such inquiry begins with a definition of the word "claim."

(b) "Claim" Defined

The plain language of § 1322(b)(2) *does not* limit its protection of residential mortgage lenders' claims to the component of such claims classified only as "secured" by § 506(a). Rather, § 1322(b)(2) prohibits modification of the rights of holders of *"a claim"* that is "secured by a security interest in real property that is the debtor's principal residence. . . . " Congress enacted the statute with a comma to separate the "modify" and the "other than" phrases of § 1322(b)(2) and, further, to maintain the independence of the latter phrase from the former. *In re: Etchin*, 128 B.R. at 668. The independence of the singular word "claim" is borne out by the statute's syntax and is subject to Bankruptcy Code definition. "Claim" is defined as the "right to payment, whether or not such right is . . . secured, or unsecured; or [the] right to an equitable remedy for breach of performance . . . whether or not such right . . . is . . . secured, or unsecured." 11 U.S.C. § 101(5)(A) (1988). Thus, the plain language of § 1322(b)(2) extends the anti-modification protection to residential mortgage lenders who hold *a claim*, without distinction as to whether that claim is "secured" or "unsecured."

The Second Circuit, in its opinion, rewrites the statute so that it would read that a plan may "modify the rights of holders of secured claims, other than [*rights related to the secured portion of*] a claim secured only by a security interest in real property that is the debtor's principal residence. . . . " *Bellamy*, 962 F.2d at 179. The statute does not, however, contain such additional language. It must be plainly read as it is written. A Chapter 13 plan may modify the rights of secured claim holders,

except ("other than") where a claim is one that is secured by solely residential real property. A natural reading of the statute, therefore, confirms that bifurcation is an impermissible modification as against the holder of a residential mortgage.

(c) Applicability of § 506(a)

The Nobelmans argue that § 506(a) defines "secured claims," pursuant to 11 U.S.C. § 103(a), for purposes of all cases under all chapters. Their reasoning follows that, when applied to § 1322(b)(2), § 506(a) *automatically* transforms the *claim* of American into secured and unsecured portions. The *Bellamy* court concurs in the position of the Nobelmans in this regard. 962 F.2d at 180-81. Applying the rule of last antecedent, the Second Circuit jumps to the conclusion that the "other than" clause must have as its subject the term "secured claim." *Id.* The *Bellamy* court ignores the fact that the modification phrase "other than" should be extended to the *entire* last antecedent, namely "the *rights* of holders of secured claims. . . . " *In re: Etchin*, 128 B.R. at 668. Such a plain reading of the statute extends the protection of anti-modification to the rights of holders of the defined type of claims. In addition, the Second Circuit fails to recognize that § 1322(b) is itself a definitional statute. The provisions of § 506(a) may be operational elsewhere within the Chapter 13 framework.

The plain reading of § 1322(b)(2) eliminates the self executing attribute accorded to § 506(a) by the pro-bifurcation courts, and at the same time allows § 506(a) to work its intended role in Chapter 13 proceedings (*e.g.*, to measure the value of secured claims under § 1325(a)(5)).

Pro-bifurcation courts mistakenly term § 506(a) as a cramdown statute. This is not the case. Section 506(a) is a mechanism to achieve property valuation. Once a valuation is accomplished, § 506(a) does *not* automatically kick in to bifurcate a secured creditor's claim. *See* Bankr. Rule 3012. *Accord Dewsnup*, 112 S. Ct. at 778. This mechanism *must* be applied to a *plan* in order to achieve such a result. The "rights" referred to in § 1322(b)(2) may be modified in a *plan*, *not* in the valuation mechanism of § 506(a). Further, application of § 506(a) to § 1322(b)(2) cannot, under the structure of the Bankruptcy Code, result in a bifurcation of *any* secured claims. Section 1322 tells us what a plan may do, what a plan may include. Section 1325(a), on the other hand, defines the standards for plan confirmation. Under § 1325(a)(5), absent creditor acceptance of a plan or Debtor's surrender of the secured property, a Chapter 13 plan will be confirmed only if:

> . . . the plan provides that the holder of such claim retain the lien securing such claim; and . . . the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim. . . .

A residential lender is, therefore, entitled – by virtue of the anti-modification provisions of § 1322(b)(2) – to lien retention and payment (distribution) of an amount that is "not less than the allowed amount of such claim. . . ." American's *allowed claim* is $71,335.04. (Petition for Cert., App. 33) Thus, since its *claim* cannot be modified, the Nobelmans' plan cannot be confirmed

unless such allowed claim is paid in full. *Accord Dewsnup*, 112 S. Ct. at 777.

Such a reading harmonizes the provisions of § 506(a) with those of § 1325(a)(5) to give effect to both, while at the same time preserving the anti-modification protection afforded to residential lenders in § 1322(b)(2). *Cf. United States v. Nordic Village Inc.*, 503 U.S.___, 112, S. Ct. 1011, 1014 (1992) (different statutory provisions should be read, where possible, as complimentary rather than in conflict with each other). In other words, a § 506(a) cramdown, liensplit or bifurcation may occur under § 1325(a)(5) with respect to secured creditors who do not benefit from the protection of § 1322(b)(2). A correct application of § 506(a) does not, therefore, condone the lien bifurcation sought by the Nobelmans.

(d) Alternatively – If a conflict exists

Alternatively, if a conflict is found to exist between § 506(a) and § 1322(b)(2), then the specific provision found in Chapter 13 *must* be accepted as controlling over the general provisions of Chapters 1, 3 and 5 which are applicable pursuant to § 103(a). *In re Schum*, 112 B.R. at 116. "This Court accepts the tenant of statutory construction that, regardless of the inclusiveness of the general language of a statute, it does not apply or prevail over matters specifically drafted within another part of the same enactment." *In re Chavez*, 117 B.R. at 744. Section 1322(b)(2) was specifically drafted to prevent modification of a claim secured *only* by a residential mortgage. As the District Court in *Nobelman* pointed out, a conflict exists between the two statutes to the extent "that

§ 506(a) may be used to undermine the protection afforded by § 1322(b)(2) under the very narrow circumstances defined by that statute." *In re Nobelman*, 129 B.R. 98, 102 (N.D. Tex. 1991). The "conflict" between § 506(a) and § 1322(b)(2), therefore, is controlled by the latter statute. As the Court in *In re Sauber*, 115 B.R. 197, 199 (Bankr. D. Minn. 1990), stated:

> [W]hat the *Houghland* Court did not seem to appreciate, is that we are dealing with general and specific concepts that are intended to apply and govern the rights of debtors and their creditors in different situations, and with different applications, depending upon particular Code purposes to be served. The application of general concepts is not universal in the scheme of the Code, but is subject to specific limitation, and even total disregard, in some instances.

Accord In re Boullion, 123 B.R. 550, 551 (the specific controls over the general). *See also In re Mahaner*, 34 B.R. 308, 309 (Bankr. W.D.N.Y. 1983) (§ 506(a) inapplicable where the statute would render a redemption provision of the Code "mere surplusage").

(e) Section 1322(b)(2) must be accorded meaning

Finally, it is nonsensical to believe that the provisions of § 1322(b)(2) kick in only after claim bifurcation. Even those courts that have interpreted § 1322(b)(2) to allow bifurcation of a claim secured by a residential mortgage

concede that a different result would be required if that interpretation left the statute "without a raison d'etre" or "led to absurdity." *In re Houghland*, 886 F.2d at 1184. The Nobelmans' interpretation of § 1322(b)(2), however, not only renders that statute meaningless, it also produces the absurd result that a statute plainly designed to accord home mortgagees *preferred* treatment, in fact, resigns them to *worse* treatment than other secured creditors under the pro-cram down philosophy.

All courts that have examined the interaction of § 506(a) and § 1322(b)(2), have acknowledged that "Congress intended to benefit residential real estate lenders." *In re Houghland*, 886 F.2d at 1185. *Accord Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 128 (3rd Cir. 1990) ("it is clear that the anti-modification provision" was "inserted on behalf of the home mortgage industry"). If, as the Nobelmans assert, a residential real estate lender can be forced to surrender its secured position in that portion of a mortgage claim that exceeds the value of the mortgaged residence, it is hard to see how § 1322(b)(2) affords the lender special protection of any significance. As the court in *In re Schum* noted, such bifurcation "would have the effect of treating real property secured by only a lien on the debtor's principal residence in the same manner as any other property secured by a lien." 112 B.R. at 162. Section 1322(b)(2), in short, would be stripped of its "raison d'etre." *Wilson*, 895 F.2d at 128. This Court should reject a construction that would render § 1322 (b)(2) meaningless. *Accord Nordic Village*, 112 S. Ct. at 1014 (a statute must be construed so that its words have some operative effect).

The Nobelmans ignore the congressionally dictated definition of "claim" in § 101(5)(A), which is a right to payment whether secured or unsecured. One court has correctly reasoned that "in order to afford § 1322(b)(2) any relevant meaning, we must find that the 'claim' referred to in this section applies to the entire claim" as defined by § 101(5) of the Bankruptcy Code and, therefore, that "this would include both the secured and unsecured potion of the creditor's claim." *In re Moran*, 121 B.R. 879, 882 (Bankr. E.D. Okla. 1990).

Rather than follow the *Houghland* line of opinions and read the general provisions of § 506 into the more specific provisions of § 1322 in order to change the meaning of the word "claim", those courts which find that § 1322(b)(2) prohibits the type of bifurcation sought by the Nobelmans actually opine that the statute means what is says. "Congress meant to establish a special protected class of creditors in a Chapter 13 case under § 1322(b)(2). To read the statute other than literally . . . is to permit inroads into a protection afforded a class of creditors by Congress." *In re Boullion*, 123 B.R. at 551. Clear statutory construction, therefore, supports denial of confirmation of the Nobelman's plan.

II.

THE COURT OF APPEALS CORRECTLY FOUND THAT THE LEGISLATIVE HISTORY OF § 1322(b)(2) PROHIBITS THE MODIFICATION OF A CLAIM SECURED BY A SECURITY INTEREST IN THE REAL PROPERTY THAT IS THE DEBTOR'S PRINCIPAL RESIDENCE.

The clear intent of Congress in enacting § 1322(b)(2) was to protect home mortgage lenders from a reduction

of their mortgage rights. *Grubbs v. Houston First American Savings Association*, 730 F.2d 236, 245 (5th Cir. 1984). "Congress intended special treatment for a creditor whose claim is secured only by a security interest in the debtor's principal residence." *In re Schum*, 112 B.R. 159, 162 (Bankr. N.D. Tex. 1990). This is equally as apparent from the evolution of the statute as from its language.

Under Chapter XIII of the Bankruptcy Act of 1898, the statutory predecessor of Chapter 13, an individual wage earner's reorganization plan could not "deal with" (*i.e.*, modify or otherwise affect) the rights of a creditor holding a claim secured by real property. Although a Chapter XIII plan could deal with other types of secured claims, "the statutory definition of the term 'claim' expressly excluded 'claims secured by estates in real property or chattels real.' " *In re Kacmarczyk*, 107 B.R. 200, 202-03 (Bankr. D. Neb. 1989) (*quoting* Bankruptcy Act of 1898, Pub. L. No. 61, 30 Stat. 544-66 (repealed 1978), § 606(1)). This resulted in "[j]udicial attempts to circumvent the rigid rule regarding treatment of secured claims in Chapter XIII, which often failed." *In re Kaczmarczyk*, 107 B.R. at 203.

Prior to enacting the Bankruptcy Code, Congress created the Commission on the Bankruptcy Laws of the United States to evaluate the existing bankruptcy laws and to recommend revisions for the reform. *Report of the Comm'n on the Bankr. Laws of the U.S.*, H.R. Doc. No. 137, 93rd Cong., 1st Sess., pt. 1, at (1973), reprinted in COLLIER ON BANKRUPTCY, App. 2 at I-1 (15th ed. 1979). The Commission suggested that in a Chapter 13 proceeding a Debtor be permitted to alter or modify claims

secured by personal property. *Id.* The Commission's proposal regarding mortgage loans was not as generous to the Debtor. The Commission suggested that the Debtor should not be allowed to modify or alter a mortgage obligation, but cure a default and continue making mortgage payments. *Id.* This new "limited authority to deal with claims secured by a lien on the Debtor's residence," the Commission stated, "does not authorize reduction of the size or varying of the time of installment payments." *Id.* House Bill 8200 chronologically followed the Commission's Report.

As originally proposed, the House version of the Bankruptcy Code completely eliminated the "rigid rule" under Chapter XIII practice by setting no limits on the ability of an individual wage earner to modify secured claims through a Chapter 13 plan. H.R. 8200, introduced before the 95th Congress, "provided that a debtor's plan might 'modify the rights of holders of secured claims or of holders of unsecured claims.' " *Grubbs*, 730 F.2d at 243-44 (quoting H.R. 8200, 95th Cong. 1st Sess. 429 (1977). Thus, as contrasted with the present language of 11 U.S.C. § 1322(b)(2) (1988), H.R. 8200 provided that any secured indebtedness could be modified, *including* indebtedness secured by a mortgage solely on the Debtor's home. At least one commentator suggests that the intent of this language was to permit "a debtor's plan to bifurcate claims into secured and unsecured claims . . . relative to personal property, not real property." Lindauer, "Optimizing the 'Fresh Start': Mortgage Cramdown under Chapter 13 of the Bankruptcy Code," 11 *J.L. & Comm.* 257, 268 (1992).

The Senate version, on the other hand, preserved the protection afforded by Chapter XIII to creditors secured

by real estate. S. 2266 provided that plans may *not* modify " 'claims wholly secured by mortgages on real property.' " *Grubbs*, 730 F.2d at 245 & n.14 (quoting S. 2266, 95th Cong., 2d Sess. (1978)). *See also* S. Rep. No. 989, 95th Cong. 2nd Sess. 141 (1978) S. 2266 would not have allowed any modifications of a debt secured by *either* commercial *or* residential real estate.

At the Senate hearings in the 95th Congress, mortgage lenders voiced concern that the House version of § 1322(b)(2) would totally abrogate the protections afforded real estate lenders under Chapter XIII. The Seventh Circuit has characterized the Senate hearings as follows:

> In the only Senate committee hearing held before the final version of S. 2266 (the Senate's bill) was introduced, secured creditors' advocated voiced no objection to the cure of default accelerations. Their opposition was directed to provisions permitting modification on a secured claim by reducing the amounts of installment payments and *reduction of the secured amount of the claim to the value of the collateral.* Hearings Before the Senate Subcommittee on Improvements of the Judicial Machinery of the Senate Committee on Judiciary, 94th Cong., 1st Sess. (1975), at 124-38 (statement on behalf of American Bankers Association), 139-84 (statement on behalf of National Consumer Finance Association). *Grubbs*, 730 F.2d at 245. At the hearings held during the 95th Congress after S. 2266 was introduced, secured creditor advocates voiced only similar objections. Hearings Before the Subcommittee on Improvements on the Judicial

> Machinery of the Senate Committee on Judiciary, 95th Cong., 1st Sess., (1977) at 652-53 (statement on behalf of National Consumer Finance Association); 703, 707, 714-15 (discouragement of savings and loan associations making home loans); 719-21 (statement of behalf of National Association of Real Estate Investment Trusts). *Grubbs*, 730 F.2d at 245 n. 13.

Matter of Clark, 738 F.2d 869, at 873-74 (7th Cir. 1984).

In testimony before the Senate Subcommittee on Improvements in the Judicial Machinery of the Committee on the Judiciary, Edward J. Kulik pointed out that reducing a mortgagee's secured claim to the actual value of any real estate securing the claim would have a dramatically negative impact on the mortgage industry. *Bankruptcy Reform Act of 1978, Hearings Before the Subcomm. on Improvements of the Judicial Machinery of the Senate Comm. on the Judiciary*, 95th Cong., 1st Sess. 709, 714 (1977). After focusing on commercial real estate lenders, Mr. Kulik turned his attention to the context of home mortgage funding and addressed the proposed provisions of Chapter 13. He emphasized that the House version of § 1322(b)(2) – which, unlike prior law, permitted modifications of claims secured by residential mortgages – would have a particularly adverse impact on the availability of home mortgage funds, especially where the financial resources of the individual home buyers were "not particularly strong." To avoid this result, he proposed that the legislation be modified to protect the *entire claim* secured by a residential mortgage. *Bankruptcy Reform Act of 1978, Hearing Before the Subcomm. on Improvements of the Judicial Machinery of the Senate on the Judiciary*, 95th Cong., 1st Sess. 709, 714-15 (1977).

It is against this backdrop that the compromise language embodied in present § 1322(b)(2) was adopted. This language preserves the protection afforded mortgage lenders under Chapter XIII of the Bankruptcy Act of 1898 and the Senate Bill, but restricts that protection (along the lines suggested by Mr. Kulik) to holders of claims secured by residential mortgages. The intent of this provision is explained in the Joint Explanatory Statement agreed on by House and Senate floor managers, published in the Congressional Record following the floor debates on the compromise bill (124 Cong. Rec. H11,107 (daily ed. September 28, 1978) (statement of Rep. Edwards); 124 Cong. Rec. S17,424 (daily ed. October 6, 1978) (statement of Sen. DeConcini)):

> Section 1322(b)(2) of the House amendment represents a compromise agreement between similar provisions in the House bill and Senate Amendment. Under the House amendment, the plan may modify the rights of holders of secured claims other than a claim secured by security interest in real property that is the debtor's principal residence. *It is intended that a claim secured by the debtor's principal residence may be treated under § 1322(b)(5) of the House amendment.*

(emphasis added).

As stated by Sen. DeConcini, the *only* permissible modification of a residential mortgage claim is that which is permitted under § 1322(b)(5). The Fifth Circuit, discussing the compromise which resulted in the final enactment, explained that:

> With regard to § 1322(b)(2), the Senate receded from its position that no 'modification' was to be permitted to *any* mortgage secured by real estate; it instead agreed to a provision that modification was to be barred only as to a claim 'secured only by a security interested in real property *that is the debtor's principal residence.*' This limited bar was apparently in response to perceptions, or to suggestions advanced in the legislative hearings, *see* note 13 *supra* [citing Mr. Kulik's testimony] that home mortgagor [*Sic*, mortgagee] lenders, performing a valuable social service through their loans, needed special protection against modification thereof (i.e. reducing installment payments, secured valuations, etc.)

Grubbs, 730 F.2d at 246 (emphasis in original). Thus, the protection afforded by § 1322(b)(2) is, as Congress recognized, appropriate and necessary.

The legislative history of § 1322(b)(2), therefore, reinforces the result reached by the Bankruptcy Court, the District Court and the Court of Appeals in this case. The intent of the statute is to preserve the availability of residential mortgage funding for individuals of modest means. The statute achieves this result by limiting any modifications of the claims of residential mortgage lenders so to entice the mortgage industry to make home loans to marginal borrowers. Nothing in the legislative history suggests that Congress intended to permit a residential mortgage lender to be "crammed-down" to the value of the collateral. Indeed, this is precisely the modification that the compromise legislation was intended to prevent.

III.

BIFURCATION OF A RESIDENTIAL MORTGAGE LIEN RUNS CONTRARY TO BASIC PRINCIPLES OF LIEN PRESERVATION UNDER BANKRUPTCY LAW.

This Court last term considered the question of whether a debtor in a chapter 7 case may " 'strip' down a creditor's lien on real property to the value of the collateral, as judicially determined, when that value is less than the amount of the claims secured by the lien?" *Dewsnup*, 112 S. Ct. at 775-76. In *Dewsnup*, the Court found a litigious debtor, who had employed several bankruptcy filings to forestall foreclosure by the secured creditor. *Id.* The debtor sought to employ in his last case the lien avoidance provisions of § 506(d) and the value reduction provisions of § 506(d) in order, in a chapter 7 proceeding, to effect an *avoidance* of the creditor's lien to the extent that it was undersecured. *Id.* In refusing to allow the debtor to use such a procedure to effect a type of "redemption" of the real property, this Court set forth several basic rules concerning the rights of secured creditors under the Bankruptcy Code. These rules are instructive to a determination of the issue now before this Court in the *Nobelman* case.

In disallowing such an avoidance, the *Dewsnup* Court looked to pre-code practice with respect to real property liens:

> This result appears to have been clearly established before the passage of the 1978 Act. Under the Bankruptcy Act of 1898, a lien on real property passed through bankruptcy unaffected. This Court recently acknowledged that this was so. See *Farrey v. Sanderfoot*, 500 U.S. ___, ___, 111

> S. Ct. 1825, 1829, 114 L.Ed.2d 337 (1991) ("Ordinarily, liens and other secured interests survive bankruptcy"); *Johnson v. Home State Bank*, ___ U.S. ___, ___, 111 S. Ct. 2150, 2154, 115 L.Ed.2d 337 (1991) ("Rather, a bankruptcy discharge extinguishes only one mode of enforcing a claim – namely, an action against the debtor *in personam* – while leaving intact another-namely, and action against the debtor *in rem*."

Id. at 778 (citing Section 67d of the 1898 Act, 30 Stat. 544, 564) (footnote omitted).

In this regard, application of the pre-Code practice to Chapter 13 proceedings mandates that the claims of residential lenders cannot be bifurcated for several reasons. First, the cram down section of Chapter 13, § 1325(a)(5)(B), requires that "the holder of such claim, retain the lien securing such claim. . . . " as a condition to confirmation. Bifurcation results in an *avoidance* of the undersecured portion of such a creditor's claim, resulting in a Debtor effecting in Chapter 13 what cannot occur under *Dewsnup* in a Chapter 7 case. Further, Chapter 13 lien bifurcation destroys the *in rem* rights which innur to the benefit of "holders of secured claims. . . . " 11 U.S.C. § 1322(b)(2). This result is not consistent with *Dewsnup*.

In addition, the *Dewsnup* Court adopted the creditor's argument, in interpreting the statutes involved, that the phrase "allowed secured claim" need not be read as an indivisable term of art. 112 S. Ct. at 777-78. "[W]e hold that § 506(d) does not allow petitioner to 'strip down' respondents' lien, because respondent's claim is secured by a lien and has been fully allowed pursuant to § 502."

Id. Such an analysis can be correctly employed in the present case.

Since American filed its claim for $71,335.04, and no objection thereto appears of record in this proceeding, this creditor holds a claim that is allowed under § 502. (Petition for Cert., App. 32-33) Further, American's claim is "secured only by a security interest in real property that is the debtor's principal residence. . . . " 11 U.S.C. § 1322(b)(2); (Petition for Cert., App. 32-33) As such, American is the holder of a claim that is within the protection of the anti-modification language of § 1322(b)(2). American's claim cannot be compromised without its consent, 11 U.S.C. § 1325 (a)(5)(A), and its lien *must* be preserved under Chapter 13 provisions. 11 U.S.C. § 1325(a)(5)(B)(i).

Preservation of American's lien is mandated also by *Dewsnup* because "[w]e think, however, that the creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and mortgagee." 112 S. Ct. at 778. It is recognized that real property liens survive a bankruptcy discharge. *See Johnson v. Home State Bank*, 111 S. Ct. at 2154. Nobelman's bifurcation of American's lien, however, takes away such protection from the creditor. If the Nobelmans complete their proposed plan (make all proposed payments) they would be entitled to a Chapter 13 discharge. 11 U.S.C. § 1328 (1988). American's lien would be gone under a bifurcation order and the Nobelman's will have achieved in Chapter 13 what they cannot achieve under *Dewsnup* in a Chapter 7 case.

IV.

THE LIEN STRIPPING PROVISIONS OF THE NOBELMANS' PLAN ARE AGAINST PUBLIC POLICY.

As stated in *Grubbs*, the compromise version of the proposed bill, which is now § 1322(b)(2), resulted because of perception that residential mortgage lenders deserve special protection against claim modification due to the fact that they provide a valuable social and public service through their loans – they allow for the American dream of home ownership. 730 F.2d at 246. Contrary to the dicta in *In re Houghland*, few residential lenders made loans with a sufficient equity cushion in anticipation of the dramatic drop in the national real estate market or with the expectation that courts would contravene Congress' intent behind § 1322(b)(2) and allow bifurcation. Nor have residential mortgage lenders provided residential loans to marginally secure borrowers fully expecting governmental insurance agencies to deny loan coverage in lien stripping cases, as has recently been the result. For example, the Department of Veteran's Affairs in General Counsel Memorandum. O.G.C. Precedent 91-1, has stated that "for purposes of claim payment," the debt will be reduced to the cram-down amount (resulting in the lender losing the difference). *See also* U.S. Department of Housing and Urban Development Letter No. 91-27 (June 4, 1991). The result reached by the *Houghland* and other similar courts simply ignores the public service provided by the residential mortgage lending industry which entitles it to the special protection afforded by a clear reading of § 1322(b)(2).

Even as recent as November 1990, Congress expressed its national housing objectives. In the

Cranston-Gonzales National Affordable Housing Act, Congress states: "The Congress affirms the national goal that every American family be able to afford a decent home in a suitable environment." Act of November 28, 1990, Pub. L. No. 101-625, 1991, U.S. Code Cong & Admin. News (104 Stat.) 4085, Sec. 101. If bifurcation is permitted generally, residential mortgage lenders will be forced to take the direction suggested by the *Houghland* court and require substantial down payments by home buyers in order to make available sufficient equity to protect the lender's investment. Such a loan underwriting requirement will reduce the number of qualifying borrowers significantly and, unless Congress decides to subsidize home purchases itself, will cripple the residential mortgage industry. The public service deserving protection as intended by Congress under § 1322(b)(2) must be preserved.

Further, the Nobelmans' construction of § 1322(b)(2) is inconsistent with the statutory scheme of Chapter 13. A Chapter 13 debtor is plainly entitled to a "fresh start". Bifurcating a residential mortgage debt provides a Chapter 13 debtor in a depressed real estate market with much more than a fresh start: it accords the Debtor a windfall. *See Dewsnup*, 112 S. Ct. at 778. Such a windfall occurs when a debtor is permitted to retain a home, "cram-down" the creditor to the depressed value of the property, and enjoy the benefit of any subsequent appreciation in the value of the property when market conditions improve – all with no obligation to pay the mortgage lender anything more than the reduced amount of the debt. Such appreciation in value "rightly accrues to the benefit of the creditor, not to benefit of the debtor . . . " *Id.*

This is precisely the abuse that residential mortgage lenders urged Congress to acknowledge and that was addressed in the compromise statutory language. The Nobelmans would have American Savings Bank take the loss for the drop in real estate values, but they want no part of such loss themselves. Further, it is doubtful that, had the property value *increased*, the Nobelmans would have shared such benefit with their lender by agreeing to pay *more* than the original loan amount.

The unfairness of the result sought by the Nobelmans here is compounded by the fact that interpreting § 1322(b)(2) to allow "cram-down" provides no immediate relief to Chapter 13 debtors and does not insure that the Debtor will be able to retain the mortgage residence. Given that a Chapter 13 Debtor may not alter the monthly payment schedule set forth in the mortgage note, reduction of the amount of the mortgage debt merely allows the Debtor to pay off the mortgage at an earlier date. There is no immediate relief to the debtor in the form of a reduced mortgage payment and thus no assistance in constructing a monthly payment schedule which would result in a confirmable plan.

Further, the Bankruptcy Code requires that bankruptcy cases under Chapter 13 be proposed "in good faith . . . " 11 U.S.C. § 1325 (a)(3) (1988). Although not addressed as a basis for denial of plan confirmation by the Bankruptcy Court, American did raise the good faith issue in its Objection to Confirmation of Chapter 13 Plan. As stated in the Bankruptcy Court's Finding of Fact, the Nobelmans propose to pay *nothing* to unsecured creditors under their plan. Certain courts have held that zero payment plans abuse the spirit of Chapter 13. *See In re*

Lattimore, 69 B.R. 622, (Bankr. E.D. Tenn. 1987); *Matter of Hurd*, 6 B.R. 329 (Bankr. D. Ind. 1980). The plan proposed by the Nobelmans in this case, in fact, reaches a level of abuse indicative of a lack of good faith.

The plan in this case would result in the Nobelmans obtaining ownership of their home free of the lien of American after payment of the "cram-down" value of the real property, with the bifurcated unsecured portion of the creditor's claim being discharged under § 1328. Such a result would enable the Nobelmans to force upon the creditor a type of "redemption," see 11 U.S.C. § 722 (1988), that is *not* otherwise available in Chapter 7 cases. Under § 722, a Chapter 7 debtor may redeem *personal* property from a creditor by paying the amount of the allowed *secured* claim. Redemption of real property under Chapter 7 is not provided for by the Bankruptcy Code. Thus, the Nobelmans are attempting by their plan to force the American into a *worse* position than that in which it would be in if this were a Chapter 7 case. At least in Chapter 7, American could elect to exercise its right to foreclose (after stay termination) and realize the benefit if immediate proceeds or possession of its collateral.

This Court, reviewing the Nobelmans' zero payment and the Chapter 13 abuse, together with public service provided by the mortgage industry, should affirm the Court of Appeals' opinion order denying confirmation.

CONCLUSION

For the above and foregoing reasons, American Savings Bank, F.A. respectfully requests that this Court affirm the Order of the United States Court of Appeals for the Fifth Circuit entered on August 13, 1992.

Respectfully submitted,

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